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FY 1987 Economic Outlook

The Japanese government's economic outlook, adopted by the cabinet December 24, forecasts 3.5 percent inflation-adjusted growth for FY 1987 (April 1, 1987-March 31, 1988), despite the adverse effects of the strong yen. This figure represents a small acceleration of the revised 3 percent rate estimated for the current fiscal year (see Table 1). Economic officials believe moderately high growth is essential to reduce the country's trade surplus and encourage a shift to domestic demand-led growth.

While the move to lower the original FY 1986 outlook of 4 percent real growth, which was based on an exchange rate of Y204=\$1.00, had been anticipated, the new estimate is substantially higher than the 2.1 percent growth projected by private-sector economists (see Table 2). This pessimism reflects

the drop in economic growth from 3.8 percent at an annual rate in the April-June 1986 quarter to 2.6 percent in the July-September period, as exports fell 4.1 percent while imports climbed 3.2 percent.

Table 1: Japanese Government's FY 1987 Forecast

(percentage change in real terms)

	Actual			Estimated	Projected
	FY 1983	FY 1984	FY 1985	FY 1986	FY 1987
Gross National Product	-3.7%	5.1%	4.3%	3.0%	3.5%
Consumer Spending	3.0	2.6	2.6	3.7	3.4
Residential Construction	-8.9	0.5	2.9	12.7	7.1
Private Capital Spending	4.9	11.4	12.9	5.2	6.6
Current Account Surplus*	\$24.2	\$37.0	\$55.0	\$88.0	\$77.0
Trade Surplus*	\$34.5	\$45.6	\$61.6	\$94.0	\$81.0
Wholesale Prices	-2.3	10.2	-2.9	-9.7	1.0
Consumer Prices	1.9	2.2	1.9	0.5	1.6

*In billions of dollars.

Finance Minister Kiichi Miyazawa said that the economy will bottom out in the latter half of 1987 if effective government policies are pursued. Tokyo is counting on domestic demand to boost the economy by 4 percent in FY 1987 and offset the external sector's 0.5 percent negative impact. The outlook calls for a 3.4 percent increase in consumer spending, which would be the largest since FY 1982. Residential construction and private capital spending are expected to remain strong, increasing 7.1 percent and 6.6 percent, respectively. Mining and manufacturing production is expected to reverse this year's decline with a 2.2 percent rise in FY 1987, which should keep unemployment under 3 percent.

The government's outlook for the coming fiscal year assumes that the exchange rate will remain stable at ¥163=\$1.00. Tokyo expects the 60 percent appreciation of the yen since February 1985 to produce a modest decline in its trade and current account surpluses, reversing four consecutive annual increases. The outlook's \$77 billion current account surplus in FY 1987 would be equivalent to about 3.6 percent of nominal gross national product, down from an estimated 4.3 percent in the year ending in March 1987.

Private-sector economists forecast FY 1987 real growth in the 1.6 percent to 3.5 percent range, with an average of 2.4 percent. The Research Institute of the National Economy, which agrees with the government's figures, expects record low interest rates, increased government spending under the Fiscal Investment and Loan Program, and improved terms of trade to boost the economy. Continued low inflation, it forecasts, will increase real income and encourage consumer spending, while investment remains strong in the nonmanufacturing sector.

Table 2: Summary of Private Forecasts

(percentage change in real terms)

	GNP FY 1986	GNP FY 1987	Current Account Surplus*	Y/\$ Exchange Rate	Oil Price (\$/barrel)
<u>Banks</u>					
Hokkaido Takushoku Bank	1.8%	2.1%	\$74.3	¥170.5	\$15.1
Fuji Bank	2.0	1.7	70.0	161.0	17.5
Taiyo Kobe Bank	2.0	2.5	84.6	162.5	14.5
Sumitomo Trust	2.1	3.0	76.8	160.0	15.1
Mitsubishi Trust	2.1	2.4	75.7	157.0	15.6
Bank of Yokohama	2.1	1.9	65.6	160.0	15.0
Dai-Ichi Kangyo Bank	2.2	2.6	88.5	150.0	15.0
Nippon Credit Bank	2.2	2.7	72.5	157.5	16.5
Yasuda Trust	2.2	1.9	86.1	160.0	15.5
Bank of Tokyo	2.3	2.7	72.2	153.5	15.6
Mitsui Trust	2.3	1.9	70.4	154.3	15.0
Tokai Bank	2.4	1.6	80.0	150.0	15.0
<u>Insurance Companies</u>					
Asahi Mutual Life	1.9	2.6	96.5	159.0	15.5
Tokio Marine	2.1	2.5	71.2	163.0	15.6
Meiji Mutual Life	2.3	2.4	75.6	157.5	15.0
Nippon Life	2.4	2.3	88.0	160.0	17.0
<u>Research Organizations</u>					
Mitsubishi Research Institute	1.9	1.8	86.8	163.0	16.0
Okasan Economic Research Institute	2.1	2.3	87.1	152.5	15.0
Kangyo Kakumaru Research Institute	2.1	3.0	82.6	165.0	16.0
Nomura Research Institute	2.2	2.3	73.5	152.0	13.0
Cosmo Research Center	2.3	2.7	73.9	160.0	14.8
Japan Economic Research Center	2.3	3.1	85.7	151.3	15.9
Nikko Research Center	2.4	2.7	73.9	161.5	16.0
Sanwa Research Institute	2.5	2.5	73.1	158.0	15.0
Research Institute of the National Economy	2.5	3.5	81.3	155.0	14.8
Average	2.1	2.4	78.6	158.1	15.4

*In billions of dollars.

Most economists, though, expect the effect of the strong yen to keep growth under 3 percent in FY 1987. According to Nomura Research Institute, for example, export volume will drop 4.2 percent, reducing corporate profits and limiting wage increases. This, in turn, will have a negative effect on business investment and consumer spending. As a result of slower growth, Sanwa Research Institute expects unemployment to reach a record 3.5 percent by the end of FY 1987.

Randall S. Jones

Currency Realignment In 1986

Last year was a turbulent period in foreign exchange markets, marked by a continuation of the yen's appreciation against the dollar that began in March 1985. The yen's rise during the first eight months of 1986 increased its average annual value to Y168.5=\$1.00 (see Table 1). Although it remained relatively stable during the last few months of the year, by yearend there were signs that the Japanese currency was poised for further gains.

Table 1: Yen-Dollar Exchange Rate, 1981-86

(monthly average)

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
January	Y202.0	Y224.6	Y232.9	Y234.0	Y254.1	Y200.0
February	205.9	235.2	236.3	233.7	260.3	184.6
March	208.8	240.7	237.9	225.5	258.4	178.8
April	215.1	244.9	237.7	225.0	251.7	175.6
May	220.7	236.5	234.8	230.7	251.6	166.9
June	224.2	251.0	240.1	233.3	249.0	167.8
July	232.0	255.1	240.5	242.7	241.7	158.7
August	233.7	258.8	244.4	242.2	237.2	154.1
September	230.0	262.7	242.7	245.2	236.9	154.8
October	231.4	271.4	233.0	246.9	214.8	156.0
November	223.7	265.1	235.3	243.3	203.9	162.7
December	218.8	242.5	234.3	248.0	202.8	162.1
Annual Average	220.5	249.1	237.5	237.5	238.5	168.5

Following former Finance Minister Noboru Takeshita's statement in January 1986 that Japanese industry could live with an exchange rate of Y190=\$1.00, the yen began a sustained rise. Worried about the impact on its economy, Tokyo attempted to stabilize exchange rates through market intervention and official discount rate cuts at the end of January and again in early March and late April. But the yen, aided by falling oil prices and the sluggish U.S. economy, continued rising to a postwar record high of Y152.55 on August 20, 72.8 percent above its February 13, 1985 trough and 58.6 percent higher than its value prior to the September 22, 1985 Group of Five meeting.

Having seen that a weaker dollar alone was not going to significantly reduce the huge U.S. trade deficit, Reagan administration economic officials last fall began to shift their emphasis to encouraging faster economic growth in major trading partners. Moreover, Federal Reserve Board chairman Paul Volcker warned in late September that a further decline in the dollar could be counterproductive. In addition, an apparent improvement in U.S. trade figures contributed to a small rise in the dollar. The yen-dollar exchange rate remained in the Y160-Y165 zone, following an October 31 agreement between Treasury Secretary James Baker and Finance Minister Kiichi Miyazawa stating that currency values were consistent with economic fundamentals (see JEI Report No. 41B, November 7, 1986).

Although not as dramatically, the yen also appreciated against the European Currency Unit in 1986 (see Table 2). This trend was reversed during the last few months of the year, however, in the wake of the Baker-Miyazawa accord. On December 31 the yen was down 6 to 8 percent from September levels against the Deutsche mark, Swiss franc and French franc.

Table 2: Yen-ECU Exchange Rate, 1981-86

(monthly average)

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
January	Y259.8	Y239.6	Y224.0	Y188.1	Y178.3	Y178.4
February	248.4	242.9	223.1	194.1	175.9	171.1
March	251.8	243.8	223.2	193.9	174.2	170.4
April	252.6	244.5	219.9	190.2	182.3	166.1
May	244.3	244.4	215.7	187.9	181.2	161.0
June	239.0	245.5	214.3	190.3	182.4	161.3
July	239.8	244.5	211.4	190.7	186.3	157.1
August	235.3	246.4	208.3	187.9	189.3	157.4
September	243.1	247.3	206.7	181.8	185.5	159.0
October	251.3	252.5	201.8	179.7	179.6	n.a.
November	245.7	242.7	198.5	181.5	173.8	n.a.
December	237.1	231.5	192.6	178.3	177.0	n.a.
Annual Average	245.4	243.6	211.4	187.1	180.6	n.a.

This brief period of stability in the yen-dollar exchange rate ended as the yen passed the Y160 level at the end of December and continued rising in January despite intervention by the Bank of Japan. The yen rose to Y153.8 on January 14, its highest level since October 7, because of concern over the health of the U.S. economy and the announcement of a record \$19.2 billion November trade deficit, which dashed hopes that the deficit had finally bottomed out. The appreciation of the German mark against the dollar put upward pressure on the yen as well.

The Japanese government has promised to do all it can to prevent a further rise in the yen. Bank of Japan governor Satoshi Sumita said January 14 that exchange rate stability is the key to the recovery of Japan's economy.

And Mr. Miyazawa, who has stated that Y170=\$1.00 is the appropriate exchange rate, has promised vigorous efforts to stabilize the yen. But although Tokyo had a record \$42.2 billion in foreign exchange reserves at the end of 1986, intervention has little chance of reversing trends in the \$150 billion-a-day currency market.

Morgan Guaranty Trust Co. reports that although the dollar has fallen 20 percent since 1985's peak, it is still more than 15 percent above its 1980 level. Given the huge U.S. trade deficit and the sluggish economy, there is likely to be more downward pressure on the dollar in 1987. Many experts describe the dollar's sharp plunge during the past week as a free fall. Although Tokyo says that the Baker-Miyazawa accord is still in effect, Washington so far has made no move to defend the dollar. The yen is likely, therefore, to remain strong and even appreciate to new record highs in 1987.

Randall S. Jones

Education Reports: The Grass Is Greener . . .

The United States and Japan recently released reports comparing the two countries' education systems, finding much to praise and lament on both sides. Despite the efforts at evenhandedness, the overall impression is that once again the United States can learn from its Pacific partner in still another field.

Few observations contained in either of the reports surprised those who have been following the education reform debates in this country or Japan. The U.S. study praised the society-wide dedication to education in Japan; the high regard in which teachers are held (and their generally high pay scales compared with other white-collar careers); the emphasis on fundamentals; and the overall high achievement levels among students. In commenting on the study's results, however, Education Secretary William Bennett also noted the well-known disadvantages accompanying education in Japan, including the lack of attention to individual needs of students -- particularly the gifted -- and the examination pressures that follow students throughout their academic careers.

The Japanese report restricted itself to general observations on the reform movement in the United States and a broad description of education in this country. The second part of the study is due later this year, which observers hope will contain more analysis of the problems and pluses of the educational system in this country.

The studies are the result of a 1983 agreement by President Reagan and Prime Minister Yasuhiro Nakasone to address the issue in the spirit of a bilateral learning experience. While Americans may have tired of hearing how much they can learn from Japan, the U.S. report nevertheless suggests that there is much that educators can import from Japan. At the very least, the report's conclusions suggest that this country has neglected the fundamentals, although it found certain admirable characteristics in the U.S. system compared with Japan's.

In Japan the report may be more helpful in maintaining the momentum for education reform rather than because of its conclusions. By endorsing many of

changes was passed last year, the Ministry of Justice is still writing its regulations, as is Nichibenren. Furthermore, the local bar associations have not begun to consider new regulations for foreign lawyers, which could mean further delays.

Japanese government officials are aware of the U.S. position but are not expected to respond until after Nichibenren's annual meeting January 24. Nichibenren is expected to discuss the regulations for foreign lawyers and MOJ will probably take its cue from this debate. In the past the group of Japanese lawyers giving advice on international transactions has been extremely reluctant to open the door to foreigners. While the administration and the ABA feel Tokyo is reneging on a commitment to draft rules with an eye toward foreign legal realities, the government has put off action while waiting for the influential Japanese bar association.

Two factors make the issue more sensitive in 1987. First, the mainstream of the ABA is now demanding freer access to practice in Japan. Major law firms with considerable political clout feel they have given Tokyo enough time to respond and that the response has been insufficient. Various forms of retaliation are being discussed. The second factor is the shift to a Democratic Congress, making retaliatory legislation more likely if Japan is perceived as blocking access to an important services market. With only a short time before the reforms go into effect, Tokyo must tread carefully to defuse the situation.

Jon Choy

Another Year Of Japanese Car Export Limits Expected

Total U.S. retail car sales broke a 13-year-old record in 1986, expanding by 3.7 percent to 11,452,310 units and finally topping the previous all-time high of 11,446,589 cars set in 1973. But this achievement was no cause for celebration in Detroit -- or, for that matter, in Japan. For starters, sales of domestically made cars barely exceeded 1985's figure with volume up just 0.1 percent to 8,214,663 units. Then there was the fact that this slim gain was entirely the result of higher sales of cars assembled by Honda of America Manufacturing Inc., New United Motor Manufacturing Inc. (the Toyota Motor Corp.-General Motors Corp. joint venture) and Nissan Motor Manufacturing Corp. U.S.A., which jumped from 221,364 units in 1985 to 465,637 vehicles last year. For the U.S. Big Three, in short, 1986 marked the end of the turnaround that started in 1983 as non-captive retail deliveries dropped by 179,931 units (2.3 percent) to 7,602,261 vehicles.

With sales of domestic makes stalled, imports had the dubious honor of pushing total U.S. retail sales above 1973's record tally. Purchases of imported cars climbed 14.1 percent to a new high of 3,237,647 units, but as executives of the leading Japanese automotive producers are quick to point out, the fourth consecutive annual increase in foreign car sales was only partly the result of bigger sales of vehicles made in Japan. Sales of Japanese cars added up to 2,375,819 units for a gain of 7.1 percent or 157,959 more cars. Korea's Hyundai Motor Co., though, sold 168,882 cars in its first year of marketing in the United States. Moreover, fully two-thirds (105,819 units) of the extra

U.S. Retail Car Sales, 1981-86

Manufacturer/Seller	(units)				
	1981	1982	1983	1984	1985
Toyota Motor Corp.	576,491	530,246	555,766	557,981	620,047
Nissan Motor Co., Ltd.	464,805	470,246	521,902	485,298	535,372
Honda Motor Co., Ltd.	370,705	365,865	350,670	374,819	406,413
Mazda Motor Corp.	166,105	163,638	173,388	169,666	211,093
Fuji Heavy Industries, Ltd. (Subaru)	152,062	150,335	156,840	157,385	178,175
Mitsubishi Motors Corp.	0	3,950	32,755	39,104	49,734
Isuzu Motors, Ltd.	17,805	15,462	20,731	17,233	26,953
Mitsubishi Motors Corp./Chrysler Corp.	110,940	102,227	103,569	91,718	105,213
Isuzu Motors, Ltd./General Motors Corp.	0	0	0	2,077	53,968
Suzuki Motor Co., Ltd./General Motors Corp.	0	0	0	10,927	30,892
General Motors Corp.	3,796,696	3,515,660	4,053,561	4,587,508	4,607,458**
Ford Motor Co.	1,380,600	1,345,698	1,571,321	1,979,317	2,070,392
Chrysler Corp.	729,873	691,703	841,622	986,998	1,139,936
American Motors Corp.	136,682	112,433	193,351	190,255	123,449
Volkswagen of America Inc.	162,445	91,166	85,045	73,838	77,535
Honda of America Manufacturing Inc.	0	0	50,402	133,601	145,976
New United Motor Manufacturing Inc./	0	0	0	0	35,594
General Motors Corp.	0	0	0	0	0
New United Motor Manufacturing Inc./	0	0	0	0	0
Toyota Motor Sales USA Inc.	0	0	0	0	0
Nissan Motor Manufacturing Corp. U.S.A.	0	0	0	0	39,794
Total Japanese Imports	1,858,913	1,801,969	1,915,621	1,906,208	2,217,860
Total Imports	2,326,376	2,221,398	2,382,799	2,439,848	2,836,973
Total Domestic Makes	6,206,296	5,756,660	6,795,302	7,951,517	8,204,540
Total Market	8,532,672	7,978,058	9,178,101	10,391,365	11,041,513
Market Share of Japanese Imports	21.8%	22.6%	20.9%	18.3%	20.1%
					20.7%

*Includes 52,869 Acuras.

**Includes the Nova made by New United Motor Manufacturing Inc. (see below).

Source: Automotive News

Japanese imports retailed in 1986 had a General Motors or a Chrysler Corp. nameplate on them.

Automotive industry analysts expect 1987 to be a good year for U.S. car sales but not as strong as 1986. In the consensus view GM, Ford Motor Co. and Chrysler will have trouble matching last year's sales numbers for domestic makes even with the aggressive use of incentives because of a projected cutback in consumer spending on durables and stiffer import competition. That competition is not likely to come from Japan. Trade and industry watchers uniformly take as a given a seventh year of limits on Japan's U.S.-bound car shipments, reasoning that soft demand for the Big Three's products and continued protectionist sentiment on Capitol Hill leave Tokyo no choice but to extend the restraints beyond March 31.

Convinced as well that export restraints have become an institutionalized part of U.S.-Japan trade, American automotive executives and United Auto Workers union officials are trying to win a rollback in the shipment ceiling, which is set at 2.3 million vehicles for the April 1986-March 1987 period. This is hardly a new campaign; however, it did gain an important backer last fall when GM chairman Roger Smith, in an about-face, called on Tokyo not only to continue the restraints but also to reduce the number of cars shipped to this country (see JEI Report No. 39B, October 24, 1986). Moreover, supporters of a rollback have come up with a new justification now that they can no longer use the U.S. industry's weak financial position as the rationale. Their current argument is that the quota should be cut by several hundred thousand units to offset part of the growth of production of "transplants" -- Japanese cars assembled in the United States.

This line of reasoning has drawn a predictable response in Japan. Having accepted Detroit's earlier challenge to manufacture where they market, Japanese car makers wonder why they should now be penalized. The fact remains, though, that the fast-expanding output of transplants will cost Detroit some sales. Honda, which continues to be able to sell every car it can ship to dealer showrooms despite sticker prices that average roughly \$1,700 more than in mid-1985, plans to turn out 320,000 Accords and Civics at its Marysville, Ohio plant this year compared with a 1986 total of some 233,440 units. Nissan's Smyrna, Tennessee factory should be able to assemble 150,000 Sentras in 1987, while NUMMI is expected to build about 50,000 Corolla FX-16s for sale by Toyota as well as approximately 200,000 Chevrolet Novas. Adding to the marketing pressure, Mazda Motor Manufacturing (USA) Corp.'s Flat Rock, Michigan facility will come onstream in September 1987.

Susan MacKnight

Notes

- On January 6 the United States announced it was drastically reducing the amount of fish foreign fishing vessels can take within the 200-mile U.S. economic fishing zone. Hardest hit are the Japanese, who may see their haul slashed from 1986's 474,000 metric tons to just 24,776 metric tons. This harsh action has prompted speculation by Japanese fisheries officials that Washington plans to cut the foreign quota to zero next year. Although foreign ships may